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TAXATION OF PENSIONS, ANNUITIES AND BONUSES

It is a matter of universal recognition that personal service income should be more lightly taxed than property income. In taxing personal service income, actual legislation in Japan has been apt to designate the sphere of personal service income somewhat arbitrarily. In the first place, there is an almost infinite variety of degree in both personal service income and property income, and it is almost impossible to draw a clear line of demarcation between these two classes of income. Some personal service incomes especially vary in respect of certainty of receipt and ability to bear taxation. But it is technically impossible to designate the differences with precision. In actual practice, some general standard must be adopted. Thus, our taxation system approximately fixes the sphere of personal service income which is more lightly taxed than property income. Article 15 of our Income Tax Law includes under the head of personal service income not only salaries, wages and annual stipends all of which are undoubtedly personal service incomes, but also

bonuses, annuities and pensions, and it is difficult to see why these latter forms of income should, for taxation purposes, be in the same class as the former. It is true that pensions, annuities (especially in the form of a reward for past services) and bonuses are generally regarded as personal service incomes and are the fruits of personal service. However, when viewed from the faculty theory, they may be considered as greater than the former. There are reasons for taxing them heavily. I shall discuss this point in the present article.

PART I TAXATION OF BONUSSES

Let us see whether it is equitable and appropriate to regard a bonus as a personal service income and to give it preference over property income. There are reasons pro and con which I wish to compare and study.

(1) Reasons in favour of heavy taxation.

(a) A bonus is regarded as surplus income. The first reason is that a bonus is given to employees in addition to their regular salaries. If they are to conduct their domestic economy on a rational basis, employees should base it on their regular salaries, and they usually do. For this reason, a nominal or a substantial increase or decrease in a person's salary will have a serious result on the living. The amount of the tax taken out of his income is an important matter for him. Thus, the tax on his income will prove quite burdensome to him. On the other hand, if he is given an extra income, such as a bonus, he can place it outside his daily living expense. If he manages his household economy in a rational way, he should not depend on that extra income, although it may be used for emergency purposes. Thus, if a tax is taken out of this form of income, the burden will not prove so heavy as when it is taken out of his regular salary or wages. For this reason, *ceteris paribus*, a bonus should be more heavily taxed than regular incomes such as salaries or wages.

(b) A bonus is said to contain the element of unearned gain. It goes without saying that a bonus is given as a reward for service and that it is not an income from property. However, there is some element of unearned income in it and therein lies one reason for its heavier taxation as compared with regular personal service income. Viewed from this angle, it may even be said that a bonus should be taxed more heavily than ordinary property income. Primarily, salaries and wages are fixed in conformity with the positions and the work of the persons concerned and are supposed to be adequate for their living expenses and as a reward for their service. A bonus lies outside salaries and wages, and only to a very small degree is it supposed to be a supplement to salaries and wages. In the main, it is a dividend of the gain derived from fortunate circumstances. The amount of the bonus depends in part on the nature of work rendered by individual persons but is largely determined by the nature of the circumstances at a given time. A bonus cannot be large during bad times. Thus, it may be said that a bonus contains a large element of unearned income and that for this reason it should be taxed more heavily than salaries and other regular personal service incomes.

(c) The possibility of its being spent for wasteful and luxurious purposes is very great. We have observed that salaries and wages are fixed as living expenses in conformity with the positions of persons, and for this reason the possibility of their being used for luxurious purposes is small. On the other hand, a bonus, being an extra income, is apt to be used for purposes detached from daily living and the maintenance of one's social position. The possibility of its being used for extravagant objects is quite great. Such extravagant expenditure is apt to prevent re-investment in national economy, and for this reason bonuses should be heavily taxed. Viewed also from a social standpoint, heavy taxation of bonuses will result in much greater benefit on the part of the poor than the sacrifice made by the taxpayer. All these considerations seem to justify the heavy taxation

of bonuses. As has been said, bonuses are intended in some degree as a supplement of salaries. Some workers are able to make both ends meet only with the help of the bonus. In this respect, there is no possibility of its being used for extravagant purposes. But this is true only in respect to a small portion of bonuses. So long as the greater portion of bonuses is consumed outside of living expenses, the above contention holds good. Some invest their bonuses and it may be said that the heavy taxation of bonuses for such people would prevent such investment. On the other hand, the fact remains that it is very seldom that people invest their bonuses, the greater portion being actually consumed on luxuries. Thus, the heavy taxation of bonuses will, on the whole, bring no evil result.

(d) Some workers do not receive any bonus and are thus placed in a disadvantageous position compared with those who do. A bonus may be either part a salary or a supplement to it, but it may also be something else. It has the element of unearned income and so is liable to luxurious consumption. Thus, its heavy taxation is justified. If all workers received bonuses, its heavy taxation would not be necessary, but as a matter of fact, only a portion of the total number of workers receive such extras. Others either receive no bonus at all or only a negligible amount, the bonus being, in some cases, as small as two per cent. of the salary. Those who get a large bonus should be thankful for their lot and ready to pay a heavier tax on it.

(e) The heavy taxation of bonuses will lead to a better method of payment of wages and salaries. Our tax law treats salaries and bonuses in the same way. Now, this has led to our business men paying comparatively small salaries and comparatively large bonuses to their employees. This has created the delusion that the employees are greatly indebted to their employers for such large bonuses, which, in reality, are nothing but part of their salaries to which they are rightly entitled. But, if the tax law is so revised as to tax bonuses heavier than salaries, this irrational method of

wage payment will be improved ; part of the bonuses having the element of salary, such part will then be included in the regular salary, while a bonus will be given either as a reward for a man's special services or as a dividend in consideration of good business results. All this will be conducive to a fairer distribution.

(2) Reasons in favour of the traditional light taxation—or negative reasons. I have so far presented reasons in favour of the heavy taxation of bonuses, but now I shall take up some of the opposite reasons.

(a) Bonus payments are uncertain and not continuous. While wages and salaries are regularly paid out, the payment of bonus is not certain. If you get it this year, there is no guarantee that you will get it next year. You cannot count on it. Those who receive a bonus cannot use it all for their regular living expenses ; they must save part of it, at least, for the future when no bonus will be given or when the amount will be small. Under these circumstances, bonuses should rather be more lightly taxed than salaries, because it will be more difficult to pay the tax out of a bonus than out of a salary. In actual practice, however, the payment of bonuses according to the positions of individuals is well-nigh fixed and certain. The uncertainty of their payment is abstract rather than real. Actually, bonuses, in most cases, are given with certainty. For this reason, this argument against the heavy taxation of bonus has no great weight.

(b) The possibility of variation in the amount of bonus. If the amount of a bonus were about the same for different times, or tended to increase, as in the case of salaries, its recipient could spend it with an easy mind, but such is not the case. Its amount varies at different times. Let us suppose that one's household economy is based on the sum of one's salary and the average amount of bonus. If the tax on bonus is levied when the amount is very small, the burden will seem unbearable. On the other hand, when a man's bonus is large, he should reserve part of it for future

emergencies, that is, when his bonus is small, and for this reason the burden of the tax will also seem unbearable even when he receives a large bonus. Thus, it is not fair to impose a heavy tax on bonuses which vary in amount at different times. In actual practice, however, the amount of a bonus is roughly fixed, and for this reason the burden of the tax cannot be very heavy.

(c) The heavy taxation of bonuses is liable to give rise to several undesirable consequences.

First, it encourages false statements to the revenue office. Statements to the revenue office are honestly made if bonuses are lightly taxed, but if they are heavily taxed, taxpayers will be encouraged to make false statements. Such a dishonest practice will also have a serious financial effect. However, much will depend on the moral standard of the people. If a people have a high moral standard, there will not be any occasion for serious anxiety from this direction.

Secondly, it discourages saving and encourages wasteful expenditure. If both bonus and salary are taxed equally, part of the salary will be given as bonus (which is regarded as the benevolence of employers). Thus, employees live on their salaries and save the greater portion of their bonuses. But if bonus is taxed more heavily than salary, employers will increase salary and correspondingly decrease bonus, while employees will base their household economy on this increased salary, and the amount of their saving will be accordingly reduced. This is undesirable when viewed either from the standpoint of economic policy or that of social policy. On the other hand, it may be said that this increase of salary and reduction of bonus is nothing but the improvement of the present method of payment to employees. It may also be argued that even when the bonus is heavily taxed, those who now indulge in wasteful expenditure will continue their extravagance, and those who are thrifty will continue to be so, so that there will not be much difference after all.

Thirdly, dissatisfaction will come from company directors

who get large bonuses. It may be easily conceived that the heavy taxation of bonuses will especially hit the directors of big companies who receive large sums under this head. This may entail some difficulty in political affairs, but such difficulty cannot be helped if we are to effect such a reform in taxation.

We have seen that there are many good reasons in favour of the heavy taxation of bonuses, although there are some difficulties involved. I am of the opinion that bonuses should be taxed more heavily than salaries.

PART II TAXATION OF ANNUITIES

Let us now consider the taxation of annuities. By annuities I mean annuities for meritorious services to the State and part of personal service income, and I exclude yield from government bonds and postal annuities for life or for fixed periods, all of which are not to be regarded as personal service income. The annuity here meant is the extension of salary or wage or bonus (as against the bonus which is remuneration for present or recent service and in consequence part of the present salary or wage or in a different form). Whereas a bonus is temporary and uncertain in nature, an annuity has certainty and continuity, as it is given either for life or for some fixed period of time. Lack of certainty and continuity may stand in the way of a heavier taxation of bonuses over salaries, but this handicap is lacking in the case of the heavy taxation of annuities. I shall discuss this point in the following pages.

(1) Reasons in favour of the heavy taxation of annuities.

(a) An annuity is of the same nature as property income in so far as one is able to receive it without actually working. Wages and salaries—and for that matter, bonuses also—are given a person for his present service. An annuity, on the other hand, is given consideration of his past service, and it is because of this that an annuity has the character

of personal service income. The fact remains, however, that the recipient of an annuity renders no actual service while receiving the annuity. No special recreation or nourishment is required, and he will be better able to bear the tax burden than in the case of ordinary earned income. In other words, reasons for the consideration which may be given to ordinary personal service income are lacking in the case of an annuity. On the other hand, a word is necessary in defense of the annuity: although it is a property income in form, it is really quite different inasmuch as it is not derived from any investment.

(b) It has the elements of certainty and continuity. The amount is fixed, and the continued payment is certain. It is paid by an organization which inspires a high degree of confidence. Once fixed, the annuity will be paid continuously and without failure, unless some great catastrophe should make its payment impossible. The payment of an annuity ends with the death of the recipient, but this is also true of salaries. An annuity ensures a greater ease of mind than does a salary, inasmuch as payment of it cannot be stopped by illness, physical disability or old age, as in the case of a salary. Moreover, whereas a person, if he is to conduct his household economy on a strict basis, cannot depend on any fixed amount of bonus, because its payment and amount are uncertain, he knows beforehand how much income he will receive from an annuity until his death. Nor does he have to save part of it for future emergencies. Thus, he ought with ease to be able to pay part of it as income tax. Therefore, the consideration hitherto given to annuities is not really necessary.

(c) In amount it may at times be above the existence-minimum. If the amount of an annuity is negligible,—so small that it is below the existence-minimum,—then it does not concern us here. But if the amount is fairly large so that alone, or with the addition of other sources of income, it does provide means above the existence-minimum, then the recipient is assured of a certain and regular means of

subsistence, and is able to pay a tax out of it. His surplus portion is liable to be used for luxurious purposes, if no tax is imposed thereon. It may be a pleasure for him to pay a tax out of this surplus. Its heavy taxation to prevent the luxurious expenditure of this surplus will be desirable from the viewpoint of social economy and social policy.

(d) There are frequent cases in which persons can easily bear the tax burden as they have other sources of income in addition to their annuity. For some, however, their annuity is their only source of income, and in some cases it is below the existence-minimum. But in many cases persons receiving annuities have other sources of income such as property income, personal service income or pensions, so that they have a surplus power in their living. They can bear the tax burden with greater ease under such circumstances. This will be especially so when a person drawing an annuity has a property income which is more than the existence-minimum. If consideration is shown to those who enjoy incomes which exceed the existence-minimum, the possibility of a surplus in living expenses for luxurious purposes will be very great. As has been already stated, social policy demands the heavy taxation of such income in order to prevent extravagance.

(e) If bonuses (which are paid irregularly) are heavily taxed and annuities (which are regularly and continuously paid) are lightly taxed, an attempt will be made in commercial circles (ever on the alert to seize all opportunities for gain) to change bonuses into annuities for the purpose of tax evasion. If bonuses are to be heavily taxed, it follows that annuities should also be heavily taxed.

(2) Reasons in favour of light taxation of annuities. We have noted reasons in favour of the heavy taxation of annuities. But there are opposite reasons which I wish to take up in the following pages.

(a) An annuity is a personal service income in its nature. We are here concerned only with annuities which are paid yearly in consideration of past services. It is part

of one's salary as well as a bonus extended into the future. An annuity is an extended salary and bonus. Persons do not feel any pain of effort at the time they receive their annuities, which, however, are the reward of their past service and toil. When persons recall their past service and toil, which now bring them their annuity, the tax levied thereon will seem to fall heavily on their shoulders. Thus, an annuity should be taxed the same as personal service income.

(b) An annuity is often the result of service in which human lives are imperilled. Many persons receive annuities because of perilous service in which they risked their very lives. Heavy taxation can be borne if it is levied on the result of ordinary service, but it should not be imposed so as to fall on persons who have engaged in such risky undertakings. But this argument does not apply to all cases of annuity.

(c) The right of receiving an annuity is personal and cannot be an object of economic transaction. At first glance, an annuity appears to be an income from property because it yields an income regularly and certainly without endeavour on the part of the recipient. But it is something much weaker than a property right, which transcends personal relations, inasmuch as it belongs to a particular person, ends with his death, is incapable of transfer or of serving as security for loans. Because of this peculiarity, it should be more lightly taxed than property income, even if it is taxed more heavily than personal service income.

(d) An annuity is ordinarily smaller in amount than either salary or pension and is not usually sufficient for living. For this reason, it is more proper to regard it as something supplementary and tax it the same as salary. If the amount were large, it should be taxed heavily, but since it is small it should be lightly taxed. Of course, in so far as there are other forms of income which with the annuity make up a large amount exceeding the existence-minimum, reasons for the heavy taxation of the annuity will remain

appropriate.

(e) Some recipients of annuities live on this source alone and their living is below the existence-minimum. Some live only on their annuity, while others receive so small an amount that it is below the existence-minimum even when other forms of income are added to it. Some are so old that they are not able to earn any income by working. In such cases, consideration should be shown only from the viewpoint of the amount of the annuity.

We have seen that there are reasons pro and con regarding the heavy taxation of annuities. Of course, there are cases in which exception should be considered. However, apart from such individual cases, it may be said that annuities should be more heavily taxed than ordinary earned incomes.

PART III TAXATION OF PENSIONS

A pension is an extension of salary. It is of the same nature as an annuity in that its payment is not based on present service. But whereas the annuity is the direct extension of the bonus and the indirect extension of the salary, the pension is the direct extension of the salary. Both the annuity and the pension have many similarities. Let us now consider how pensions should be taxed.

(1) Reasons in favour of the heavy taxation of pensions.

(a) A pension is of the same nature as property income in that it is not based on present service. Pensioners do not work for their pensions. They experience no pain of toil and do not need any special recreation or nourishment in order to gain their pensions. In this respect, they are in the same position as the recipients of property income and are capable of bearing the tax burden with ease. Nay, pensioners are in a more advantageous position than property owners inasmuch as the former do not have to make any investment as is the case with the latter.

(b) It is certain and continuous in payment. The payment of a pension is certain and continuous and regular, as in the case of an annuity. Pensioners are perfectly assured of payment at regular intervals. They need not make any saving in so far as their income from this source is above the existence-minimum. They can spend the entire amount if they like without any anxiety for the future. They can, therefore, bear the tax without difficulty. The burden of taxation will be much easier for a pensioner to bear than for a salaried man, assuming their incomes are the same in amount. Certainty of payment will be absolute when pensions are given by the State. Such pensioners will be in even a better position than the recipients of property income or business income. Those who live on interest from loans are exposed to the possibility of depreciation in interest rate and even of losing the principal. Business men are in a constant fear of variation in business conditions. But pensioners, especially those who are given State pensions, are secure unless, indeed, the State itself is overthrown.

(c) The amount of a pension is usually large and well above the existence-minimum. Usually annuities are small in amount and are not sufficient for living expenses. But in a great number of pensions, they are more than enough for maintaining living on a minimum basis. Since pensioners get their income without failure and without service, and at regular intervals, they can use part of it for luxurions purposes. Persons having such surplus power of living should be taxed heavily not only from the principle of ability to pay but also from the standpoint of the heavy taxation of luxury.

(d) Some of pensioners earn income from other sources so that the total amount of their income will be relatively large. At least they are in a position to make such earnings. Such persons may be taxed especially heavily. However, others have pensions as their only source of income. But even these people are in a position to derive income from other sources to some extent. In this respect, pensioners are in the same position as the owners of property. They

are in a more advantageous position than are workers and salaried men whose income is limited to their salaries and wages.

(e) Some pensioners also receive annuities and income from property, so that the combined amount reaches big proportions. We have already seen that pensioners are in a position to earn personal service income. But some of them also receive annuities and property income which make the payment of the tax an easy matter. The number of such pensioners may not be large but they certainly exist. No claim for light taxation should be allowed to such pensioners. The new pensions act has a provision for the partial suspension of state pensions to such people. Consideration should not be shown to such pensioners from the standpoint of this new act.

(f) Claims for light taxation should not be conceded to pensioners because of the contrasting fact that the great majority of the people are not entitled to receive pensions. While former government officials are able to live with comfort and without anxiety as they are given pensions for their past services, the common people—farmers, artisans and tradesmen—do not receive any pension although they have rendered service to society and the State and are often faced with much difficulty in living in their old age. Pensioners should certainly be grateful for their present fortunate circumstance. They should decline all concession in taxation. Nay, they should even be willing to pay a heavy tax on their income.

(2) Reasons in favour of the light taxation of pensions.

(a) A pension is part of personal service income. Although a pension is not accompanied by present service, the fact remains that it is a reward for past service. There can be no pension where there is no past service. It is nothing but a part of salary extended into the future and paid after the retirement of a person from his service. In view of his past toil and painful effort, his pension should be entitled to light taxation. In England, a pension is treated as being on

a par with salary. This is rightly so. However, since the pensioner's pain of effort is not felt at present, a pension cannot be treated as a salary, which is accompanied by present pain of effort.

(b) A pension is personal in nature and cannot be transferred or sold. Property income can be passed on to one's posterity, or can be sold or pledged as security for loans. But a pension ends with its recipient, cannot be negotiated and is subject to limitation as security for loans. As it has weaker economic power than property income, it should not be taxed the same as the latter.

(c) The amount of a pension being usually very small—much smaller than the pensioner's former salaries—they will have to lower the standard of their living. Although this is not inevitable, it is a very common fact. It will be highly inappropriate to tax pensions heavily during the period of transition in which pensioners' standard of life is lowered. Once they become accustomed to pensioner's life, they will be grateful for this source of income and will gladly bear the burden of the heavy tax.

(d) Some pensioners may have no other sources of income and must depend entirely on pensions which barely exceed the existence-minimum. They are to be pitied to be sure. But inasmuch as their income exceeds the existence-minimum, there is no need of concession. They should know that there are persons who are in much more pitiable circumstances. There are many who, although they have made their contribution to the welfare of society and the State, are not entitled to any pension. Pensioners should be grateful for their income however small and willingly bear the tax thereon.

CONCLUSION

To summarise: Pensions, annuities and bonuses have enjoyed the same treatment as personal service income, and there are some reasons for the continuance of this policy. However, there are more weighty reasons in favour of their

heavier taxation. They should be taxed more heavily than wages and salaries, but not so heavily as property income. I suggest the golden mean between salary and property incomes.

MASAO KAMBE